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Nos. 725 - 726

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1947

RALPH R. ANDERSON,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

HERBERT R. ANDERSON,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

MATTHIAS CONCANNON,
WILLIAM H. DILLON,
BRUCE PARKHILL,
Counsel for Petitioners.

Schaffer Printing Company, Del. 7171

SUBJECT INDEX

	PAGE
Petition for Writs of Certiorari	1
Opinions Below	2
Jurisdiction	2
Questions Presented	2
Statute Involved	3
Statement	4
Specification of Errors Relied Upon	8
Reasons relied upon for allowance of the Writs	9
Conclusion	17

TABLE OF AUTHORITIES CITED

CASES

	PAGE
Bardach v. Commissioner, 90 F. (2d) 323 (C.C.A. 6)	12
Blair v. Commissioner, 300 U. S. 5	11, 12, 14
Chicago Title & Trust Co. v. Ward, 332 Ill. 126	7
Commissioner v. Merrell, 93 F. (2d) 466 (C.C.A. 2)	11
Commissioner v. Tower, 327 U. S. 280	14
Dobson v. Commissioner, 320 U. S. 489	16
Eisenmenger v. Commissioner, 145 F. (2d) 103 (C.C.A. 8)	9, 10
Freuler v. Helvering, 291 U. S. 35	11, 12
Helvering v. Clifford, 309 U. S. 331	13, 16
Helvering v. Rhodes' Estate, 117 F. (2d) 509 (C.C.A. 8)	10
Helvering v. Stuart, 317 U. S. 154	14

PAGE

Helvering v. Wood, 309 U. S. 344 17
Hormel v. Helvering, 312 U. S. 552 .....16, 17
Hubbell v. Helvering, 70 F (2d) 668 (C.C.A. 8) 10
Huston v. Smith, 248 Ill. 396 7
Kartun v. Kartun, 347 Ill. 510 7
Lawton v. Commissioner, 164 F. (2d) 380 (Adv. Sheet) (C.C.A. 6) 12
Lucas v. Earl, 281 U. S. 111 15
Marshall v. Commissioner, 57 F. (2d) 633 (C.C.A. 6) 12
Nashville Trust Co. v. Commissioner, 136 F. (2d) 148 (C.C.A. 6) 11
Pearce v. Commissioner, 315 U. S. 543 14
Plimpton v. Commissioner, 135 F. (2d) 482 (C.C.A. 1) 12
Poe v. Seaborn, 282 U. S. 101 14
Richardson v. Smith, 102 F. (2d) 697 (C.C.A. 2) 12
Sharp v. Commissioner, 303 U. S. 624, 91 F. (2d) 802 (C.C.A. 3) 11
Vandenbark v. Owens-Illinois Glass Co., 311 U. S. 538 10

STATUTES

Internal Revenue Code:
Section 11, 53 Stat. 5 3
Section 22 (a), 53 Stat. 9, 574 .....2, 3, 4, 7, 8, 9, 14, 15, 16

Judicial Code:
Section 240 (a), as amended, 28 U.S.C.A. §347 ... 2
26 Stat. 828, Ch. 517 § 6 as amended, 39 Stat. 727 Ch. 448 §6, 43 Stat. 940, Ch. 229 §8, Title 28 U. S. C. A. §350 2

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PETITION FOR WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

To the Honorable, the Chief Justice and the Associate Justices of the Supreme Court of the United States:

Petitioners, Ralph R. Anderson and Herbert R. Anderson, respectfully pray that writs of certiorari be issued to review the judgments (R. 139-146) of the Circuit Court of Appeals for the Seventh Circuit entered December 17,

1947, affirming the decisions of the Tax Court (R. 79-90, 100-102) sustaining deficiencies in income taxes for 1939 and 1940 aggregating $9,075.93 in the case of Ralph R. Anderson and $9,826.10 in the case of Herbert R. Anderson.

Opinions Below.

The opinion of the Tax Court (R. 79-89), affirmed below, is reported in 5 T. C. 443.

The opinion of the Circuit Court of Appeals (R. 139-145) is reported in 164 F. (2d) 870.

Jurisdiction.

The judgments of the Circuit Court of Appeals were entered December 17, 1947 (R. 145-146). Petition for rehearing was timely filed on December 31, 1947, and was denied on January 9, 1948 (R. 146, 147). The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by Act of February 13, 1925, 26 Stat. 828, Ch. 517, § 6, as amended, 36 Stat. 1157, Ch. 231, § 240, 43 Stat. 938, Ch. 229, § 1, Title 28 U. S. C. A. § 347. This petition is timely filed in accordance with 26 Stat. 828, Ch. 517 § 6, as amended, 39 Stat. 727, Ch. 448, § 6, 43 Stat. 940, Ch. 229, § 8, Title 28 U. S. C. A. § 350.

Questions Presented.

(1) Whether petitioners (the donors) are taxable under Section 22 (a) of the Internal Revenue Code upon dividends paid upon and capital gains derived from the liquidation of shares of stock which theretofore had been transferred by them to members of their families by outright gifts, valid under state law;

(2) Whether a decree of a state court upholding the validity of such gifts, entered subsequent to the conflicting decision of the Tax Court upon the same question, is binding upon the federal courts and agencies, where the state court decree is brought to the attention of the Tax Court, and it is requested to consider and give effect to it, while that Court still has jurisdiction; and

(3) Whether a decision of the Tax Court, that petitioners are taxable upon such income on the ground that they had not made valid gifts of the stock, may be affirmed by the Circuit Court of Appeals upon the entirely different ground, not previously asserted, that petitioners are taxable under Section 22 (a) of the Internal Revenue Code, notwithstanding the validity of the gifts under state law, without remanding the case to the Tax Court and granting petitioners a hearing upon the new issue.

Statute Involved.

Sections 11 and 22 (a) of the Internal Revenue Code.

"SEC. 11. NORMAL TAX ON INDIVIDUALS

"There shall be levied, collected and paid for each taxable year upon the net income of every individual a * * * tax * * * " (Sec. 11, I.R.C., 53 Stat. 5.)

"SEC. 22. GROSS INCOME

"(a) GENERAL DEFINITION. 'Gross income' includes gains, profits, and income derived from salaries, wages, or compensation for personal service, * * * of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains

or profits and income derived from any source whatever. * * *" (Sec. 22 (a), I.R.C., 53 Stat. 9, 574)

Statement.

Petitioners filed their petitions in the Tax Court of the United States seeking redetermination of asserted deficiencies in income taxes for 1939 and 1940. The deficiencies for 1939 result from the inclusion in their income of dividends paid upon shares of stock of Robert R. Anderson Company which they had given to members of their families prior to the declaration of the dividends (R. 7, 20). The deficiencies for 1940 result from the inclusion in their income of capital gains realized upon liquidation of that company on the above mentioned and additional shares of stock in the company similarly given in 1940 (R. 7, 20). The cases were consolidated for hearing and after trial the Tax Court sustained the deficiencies (R. 90), holding in its finding of facts and opinion that bona fide gifts of stock had not been made by petitioners in 1937, 1938 and 1939 (R. 87, 88-89, 100-102). A motion for rehearing was granted in part and denied in part (R. 100-102).

Subsequently, petitioners filed a motion for special leave to file a motion seeking to have the Tax Court consider a decree of the Superior Court of Cook County, Illinois, which had determined that the gifts involved were bona fide and valid (R. 102-117). The Tax Court denied that motion (R. 118).

Upon appeal the Circuit Court of Appeals for the Seventh Circuit affirmed and a petition for rehearing was denied (R. 145, 146, 147).

The facts were found in detail by the Tax Court in its findings (R. 80-87), as later amended (R. 100-102). The

facts as so found are not challenged in any material respect, except the conclusion that no bona fide gifts of stock were made. The following is a summary of the most important facts:

As of November 30, 1937, petitioner Herbert R. Anderson owned 388 shares and the petitioner Ralph R. Anderson 360 shares of a total of 750 shares of the capital stock of Robert R. Anderson Company (R. 80), a company incorporated by petitioners' father in 1914 and engaged in the paving and heavy construction business (R. 80). All but 30 of these shares were either given by their parents to the petitioners (who first became stockholders at the ages of 13 and 9 respectively) or were given to their sister and later purchased by petitioners.

In 1937, or shortly before, petitioners decided to follow the family precedent of making gifts of stock in that company to members of their families (R. 35, 46).

A series of gifts of the stock of the company were made by petitioners to the members of their families in 1937, 1938, 1939 and 1940 (R. 35, 81, 82, 83). In each instance, the stock was transferred upon the books of the company, new stock certificates were issued in the names of the donees, and, with their knowledge and consent, were placed in a safe of the company, in care of the secretary of the company, who segregated the stock of each donee and held it for safekeeping (R. 81-83, 101).

In 1937, 1938 and 1939, dividends were paid upon the stock so donated, by checks issued to the donees, who, after discussion with petitioners, loaned the proceeds from the dividends to petitioners for their interest bearing notes, which were kept in the company's safe in care of its secretary (R. 36, 37, 38, 61, 67, 69, 71, 74, 81-84, 101). Some of the dividend checks were endorsed by petitioners

or by the secretary of the company in the names of the respective payees (R. 84), with their consent or approval (R. 37, 38, 64, 67, 69, 71).

In November, 1940, petitioners, their wives, and their children, after family discussion, concluded that it would be advisable to operate the family business as a partnership rather than as a corporation, and to avoid having minors as partners, it was agreed that the children would sell their stock at its fair market value to petitioners and their wives, for interest bearing notes. An understanding was reached that when the petitioners' sons became 25 years of age or finished school they could use the notes or their proceeds to purchase an interest in the partnership, and that the daughter of one of the petitioners should receive half of her money when she became 25 years of age or married and half when she became 30 years of age (R. 85-86, 101). The sale was carried out, the notes were executed and placed in the company's safe, in the care of its secretary (R. 57, 81, 86, 101). There was a partial distribution of assets in 1940, and the liquidation of the corporation was completed in 1941 (R. 86). Income taxes were paid by donors and donees on the basis of the validity of the gifts (R. 84, 86). No question concerning partnership income is involved (R. 7-33).

The Tax Court, in its opinion, stated that "The basic question involved here relates to the validity of the gifts which petitioners claim to have made to members of their families" (R. 87). The Tax Court held that "There were no bona fide gifts of stock by petitioners during 1937, 1938 and 1939" (R. 87). No mention was made by it concerning the 1940 gifts.

Subsequent to the decision of the Tax Court, the donees brought a proceeding against the petitioners in the Su-

perior Court of Cook County, Illinois, for a declaratory judgment to determine the question of the validity of the gifts and of the notes growing out of the gifts. An *amicus curiae* was appointed by the Court who participated in the arguments. The case was submitted upon the evidence taken before the Tax Court. The Commissioner was invited to intervene and participate and the decision of the Tax Court was considered by the state court. The decree of the latter court found that the gifts were valid and bona fide and made without limitation, reservation or secret understanding, that the dividends paid by the corporation to the respective donees were the sole and rightful property of the donees to whom paid, that the subsequent sales of the stock to the parents were valid, and that the notes above mentioned were valid and binding[1] (R. 105-111). The Tax Court refused to consider the decree of the Illinois Court (R. 118).

The Circuit Court of Appeals affirmed the decision of the Tax Court, but upon an entirely different ground. The Tax Court's decision was that bona fide gifts of stock had not been made by petitioners, and it considered and decided that issue upon the basis of the evidence before it (R. 79-89, 100-102), and refused to give any consideration whatever to the Illinois decree to the contrary (R. 118). The Circuit Court of Appeals did not consider the validity or invalidity of the gifts under state law. It concluded that Section 22 (a) "is not to be circumscribed

[1] It would have been difficult for the state court, consistently with Illinois authorities, to have come to any other conclusion than that the gifts were valid. Transfers to a wife or children are presumed to be gifts (Kartun v. Kartun, 347 Ill. 510, 518; Huston v. Smith, 248 Ill. 396, 405). A transfer of stock upon the corporate books is effective to transfer title and is sufficient evidence of donative intent(Chicago Title & Trust Co. v. Ward, 332 Ill. 126, 134). The Ward case is contrary to the conclusion of the Tax Court (R. 88) that the transfer of stock upon the corporate books is not sufficient to prove a gift.

by refinements of legal title or local law concepts of ownership"; "that command over property or enjoyment of its economic benefits marks the real owner for federal income tax purposes"; and "that mere passage of title to income-producing property through devices which are valid under state law will not insulate the transferor against federal income tax liability unless the passage of title is accompanied by a complete shift of the economic benefits of ownership, direct and indirect" (R. 143). The Court said that the evidence supported the Tax Court's findings, and "that the taxpayers remained the substantial owners of the stock transferred to their respective families" (R. 143).

The Tax Court's decision was based only upon the issue of the bona fides and the validity of the gifts. That Court did not consider or make any findings of fact upon the question as to whether petitioners, under Section 22 (a), could be taxed upon dividends or capital gains derived from the donated stock, even though the gifts were valid under state law, on account of the subsequent transactions of the petitioners concerning the donated stock, the dividends therefrom, and the notes given for their borrowings. The Circuit Court of Appeals considered the latter issue only. It was an issue first considered in that Court, and one which petitioners did not have the opportunity to meet in the Tax Court and to present in that Court whatever evidence they had bearing upon it.

Specification of Errors Relied upon.

We respectfully submit that the court below erred:

(1) In failing to reverse the decisions of the Tax Court of the United States;

(2) In refusing to consider and to follow the decree

of the Superior Court of Cook County, or alternatively, in not remanding the case to the Tax Court with instructions to consider and give effect to that decree;

(3) In holding that the petitioners were taxable on dividends paid upon and capital gains derived from stock of which the donees were the sole owners, under state law;

(4) In considering a new issue raised for the first time upon appeal, i.e., that even though the petitioners' gifts of stock were valid under state law, petitioners were still taxable upon the dividends paid upon and the capital gains derived from that stock as the "substantial owners" thereof under Section 22 (a) of the Internal Revenue Code, or alternatively, if that issue may be raised, in not remanding the case to the Tax Court for a hearing thereon.

Reasons Relied upon for Allowance of the Writs.

1. The decision of the Court below that the validity of the gifts under state law is not determinative for income tax purposes is in conflict with the decisions of the Circuit Court of Appeals for the Eighth Circuit, the Sixth Circuit, and the Second Circuit.

Eisenmenger v. *Commissioner*, 145 F. (2d) 103, C. C. A. 8th Cir., is a case in which the Tax Court had held certain debenture notes were income to the beneficiary of a trust. Subsequent to its decision, the question was submitted to a Minnesota court, upon the record and briefs in the Tax Court, and the state court reached a contrary conclusion. This decision was called to the Tax Court's attention. It granted a rehearing but adhered to its previous decision. Upon appeal to the Circuit Court of Appeals for the Eighth Circuit it was held that "The decision of the state court on the question of the ownership of this property was, we think, conclusive upon the tax court and upon

this court." (145 F. (2d) 106.) That case is opposed to the decision below on the questions of the binding effect of the state court decree upon ownership, and also upon the effect to be given to such a decree when entered after the decision of the Tax Court.[2]

In *Hubbell* v. *Helvering,* 70 F (2d) 568, 669, C.C.A. 8th Cir., it appeared that in a case involving income taxes of the same trust estate for earlier years it had been held that charges for depreciation and for the undepreciated cost of demolished or abandoned buildings were not required under the terms of the trust to be reserved or set aside by the trustees for those purposes, and therefore the amounts so reserved by the trustees were distributable income to the beneficiaries of the trust, and taxable to them as income under the then applicable revenue act. Later an Iowa state court entered a decree differently construing the terms of the trust. The question was whether the federal court was bound by the state court decree in a subsequent case concerning income taxes for later years. The Court ruled that it was, although "If it were open to us in this case to construe this trust agreement, we would see no reason to change the views and conclusions stated in the earlier case."

In *Helvering* v. *Rhodes' Estate,* 117 F. (2d) 509-510, C.C.A. 8th Cir., it was held that decrees of a Missouri court finding a decedent not to be the owner of certain corporate stock were binding upon the federal courts, although the question involved was one of fact rather than of law.

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[2] The court below ruled that there was no error in overruling petitioners' motion based on the state court decree, because the decree was entered subsequently to the order of the Tax Court (R. 143). In Vandenbark v. Owens-Illinois Glass Co., 311 U. S. 538, 543, it was held that "nisi prius and appellate tribunals alike should conform their orders to the state law as of the time of the entry." Under that case, as well as the Eisenmenger case, the court below should have given effect to the state court decree.

In *Nashville Trust Co.* v. *Commissioner,* 136 F. (2d) 148, 150, C. C. A. 6th Cir., it was held that the federal court was bound by a state court decree that certain services were not rendered gratuitously,—purely a question of fact.

In *Commissioner* v. *Merrell,* 93 F. (2d) 466, 468, C. C. A. 2nd Cir., the Court held that it was bound by a state court decree covering the character of the particular transaction under consideration, although it was a decision of a lower court and appeared to be contrary to the law laid down by the Court of Appeals of New York in another case.

2. The decision of the Court below is in conflict with applicable decisions of this Court.

Blair v. *Commissioner,* 300 U. S. 5, involved a gift by way of assignment of an interest under a trust. The federal court found that the assignment was invalid. Subsequently a state court held the assignment valid. The Circuit Court of Appeals refused to be bound by the state court decision and followed its own earlier decision on the question of the validity of the gift. The Supreme Court reversed, holding that the state court decree was binding for federal tax purposes, notwithstanding the earlier federal decision. *Freuler* v. *Helvering,* 291 U. S. 35, is to the same effect.

Sharp v. *Commissioner,* 303 U. S. 624, involved a question of Federal estate tax liability, which depended upon whether decedent or a trust which he had created, was the owner of certain property at the time of his death. This was a question of fact under the circumstances of the case. The Third Circuit Court of Appeals refused to follow a state court decree holding that the property belonged to the trust, and decided (91 F. (2d) 802, 803) that while the property might belong to the trust as a matter of state

law, that did not determine who was the owner for estate tax purposes. In a brief *per curiam* opinion, this Court reversed on the authority of the *Freuler* and *Blair* cases.

3. The decision of the Court below that the petitioners were the substantial owners of the donated stock (for the reason that the donees were amenable to the donors' suggestions because of affection and filial duty) is in conflict with decisions of the Circuit Court of Appeals for the Sixth Circuit, the Second Circuit and the First Circuit.

Marshall v. *Commissioner,* 57 F. (2d) 633, 634, C. C. A. 6th Cir., involved gifts of stock by a husband to his wife, transferred upon the books of the corporation. The Commissioner contended that because the wife testified that she depended upon and was guided wholly by her husband in financial transactions and would gladly return the securities to him if he ever wished or needed them, the husband had such control over the stock as to make him taxable upon the income therefrom. This contention was rejected by the Circuit Court of Appeals.

It was the same contention involved here,—that the donors remained the substantial owners of the stock for tax purposes, not because of any legal or equitable right in the stock retained by them, but because the donees were amenable to their suggestions and advice by reason of affection and filial duty, and the gifts therefore remained subject to their "control".

Richardson v. *Smith,* 102 F. (2d) 697, C. C. A. 2nd Cir., *Bardach* v. *Commissioner,* 90 F. (2d) 323, C. C. A. 6th Cir., and *Plimpton* v. *Commissioner,* 135 F. (2d) 482, C. C. A. 1st Cir., are in accord with the *Marshall* case and are in conflict on this issue with the decision of the court below.

Lawton v. *Commissioner,* 164 F. (2d) Adv. Sheets 380, C. C. A. 6th Cir., is similar in many respects to this case, except that no state court decree was involved. A husband gave to his wife and children stock in a closely in-

tegrated family enterprise. Certain "informalities" in handling business matters existed, and management decisions were "made at the family fireside, in which all of the family stockholders of the corporation participated." It was contended that the husband had never relinquished dominion and control of the gifts and remained the owner for tax purposes, but the Circuit Court of Appeals for the Sixth Circuit reversed the Tax Court's decision upholding that contention.

4. This case is distinguishable from *Helvering* v. *Clifford*, 309 U. S. 331, 337, cited and relied upon by the court below. That decision was based upon the *retention* by the creator of a trust of a substantial "bundle of rights" in respect of the trust property, including control of investments and of the principal, coupled with the circumstances of family relationship and the short duration of the trust.

But where there is an outright gift, valid under state law, as here, the donor does not retain any rights. The state court decree, relied upon by petitioners, found that the gifts were valid and were made "without any limitation, reservation or secret understanding whatsoever" (R. 107).

The court below held "that command over property or enjoyment of its economic benefits marks the real owner for federal income tax purposes" (R. 143). But that language assumes the existence of a *right* to such "command" or "enjoyment". Such a right is negatived by the finding of the state court decree above referred to. Whatever powers the donors exercised with respect to the subject matter of the gifts after they were made were exercised by them, not by virtue of the retention of any such powers, but by the consent of the donees.[3] The donees

[3] See the authorities cited under Point 3.

had the ownership of the stock, the right of command over it, and the right to enjoy the economic benefits of its ownership.

The donees, under state law and under the state court decree, were the owners of the stock from which the dividends and the gains here sought to be taxed were derived. There is no basis upon which the donees could escape taxation upon these items of income under Section 22(a), for that section expressly includes in "gross income" "gains * * * derived from * * * sales, or dealings in property", and also "dividends". As to such income "tax liability attaches to ownership" and ownership is determined by local law (*Blair* v. *Commissioner,* 300 U. S. 5, 12). See also *Poe* v. *Seaborn,* 282 U. S. 101, 109, and *Pearce* v. *Commissioner,* 315 U. S. 543, 554.

Only one tax is payable. Nothing in the statute gives to the Commissioner the right to choose which of them, the donors or the donees, should bear the tax.

This is but an application of the rule stated in *Helvering* v. *Stuart,* 317 U. S. 154, 161, that "Grantees under deeds, wills and trusts, alike, take according to the rule of the state law. * * * Once rights are obtained by local law, whatever they may be called, these rights are subject to the federal definition of taxability." The dividends and capital gains in question were received by the donees as the owners of the donated shares. The donees have been adjudicated by the state court to be the owners and entitled to those dividends and gains. Section 22 (a), as construed in the *Poe, Blair* and *Pearce* cases, requires the donees to include such dividends and gains in their income.

Partnership income is not involved here. Therefore, cases such as *Commissioner* v. *Tower,* 327 U. S. 280, also relied upon by the Court below have no application. That

case involved the taxation to the husband of partnership income in the case of a husband and wife partnership. The Court held that Section 22(a) "broadly includes" in taxable income "all earnings of any individual 'from any source whatever' " (pp. 282, 283). The Court recognized that the partnership might be valid under state law, but held that the real issue under Section 22 (a) was who "earned" the income which under Section 22 (a) was to be taxed to the one who earned it. The Court cited and applied the doctrine of *Lucas* v. *Earl,* 281 U. S. 111, and concluded that there was ample evidence to support the Tax Court's finding that the husband earned the income (p. 292).

Here no question of taxation of earned income is involved. The income sought to be taxed consists of dividends paid upon the donated stock and capital gains resulting from its sale or liquidation.

5. The decision below so far departs from the accepted and usual course of judicial proceedings as to call for an exercise of this Court's power of supervision.

The contention made by the Commissioner in the Circuit Court of Appeals and sustained by it, based upon the theory of substantial ownership for the purposes of Section 22 (a) of the Internal Revenue Code, regardless of the validity of the gifts under state law, is a complete departure from the theory and the issues upon which the case was tried in the Tax Court.

In its findings of fact the Tax Court after stating the evidentiary facts (R. 80-87) concluded: "There were no bona fide gifts of stock by petitioners during 1937, 1938 and 1939" (R. 87). The opinion of the Tax Court commences with the statement: "The basic question involved here relates to the validity of the gifts which petitioners

claim to have made to members of their families" (R. 87), and continues with a statement of the elements necessary to make the gifts valid and then proceeds to consider the application of the facts developed by the evidence to those elements, and ends with the statement: "Considering all the facts, in the light of the close family relationship existing here, we conclude that petitioners have not sustained their burden of proving the respondent in error in his determination" (R. 89). The Commissioner's determination was "that no valid gifts" of the stock "were effected" by the taxpayers and that they were the owners of the stock during the taxable years (R. 15, 16, 28, 29).

Nowhere is the Section 22 (a) theory referred to in the Tax Court's opinion or findings, or in the Commissioner's deficiency notices (R. 14-17, 27-31, 79-89, 100-102).

Determination of the facts is peculiarly and solely the function of the Tax Court (*Dobson* v. *Commissioner,* 320 U. S. 489, 502). The conclusion of the Circuit Court of Appeals that, notwithstanding the validity of the gifts under state law, petitioners were the substantial owners of the stock in question for tax purposes, in effect was a finding of fact made by that court and not one made by the Tax Court. In making such a finding of fact, the Circuit Court of Appeals usurped the function of the Tax Court without giving petitioners a hearing upon that question of fact.

A similar change of position on the part of the Commissioner was involved in *Hormel* v. *Helvering,* 312 U. S. 552, where the court said at page 560:

> "But the Board of Tax Appeals neither found the facts nor considered the applicability of § 22(a) in the light of the *Clifford* case. Congress has entrusted the Board with exclusive authority to determine disputed facts. Under these circumstances we do not feel

> that petitioner should be foreclosed from all opportunity to offer evidence before the Board on this issue, however remote may be his chance to take his case out of the Clifford rule."

Also see *Helvering* v. *Wood,* 309 U. S. 344, 348.

In these circumstances the Circuit Court of Appeals either should have refused to consider an issue not considered or passed upon by the Tax Court (*Hormel* v. *Helvering,* 312 U. S. 552, 556), or considering the case as an exceptional one authorizing deviation from customary practice, should have remanded the case to the Tax Court with liberty to the parties to offer evidence on the new issue, as was done in the *Hormel* case.

CONCLUSION.

It is respectfully submitted that this petition for writs of certiorari should be granted.

MATTHIAS CONCANNON,
WILLIAM H. DILLON,
BRUCE PARKHILL,
Counsel for Petitioners.

April 5, 1948.